

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6791

Petition of Central Vermont Public Service)
Corporation for consent to 43d Supplemental)
Indenture to First Mortgage Bond Indenture)

Order entered: 3/19/2003

I. INTRODUCTION

On November 26, 2002, by letter dated November 25, 2002, Central Vermont Public Service Corporation ("Central Vermont," "CVPS" or the "Company") filed a petition pursuant to 30 V.S.A. § 108(a) with the Vermont Public Service Board ("Board"), seeking approval to enter into a 43d Supplemental Indenture, amending Central Vermont's First Mortgage Indenture (the "Indenture"), to allow the Company to use extensions and purchased property to satisfy Indenture Renewal Fund requirements, as extensions and purchased property may not now be used because of the existing Second Mortgage on such property. In support of this petition, Central Vermont submitted the prefiled Direct Testimony and exhibits of Alf R. Strom-Olsen, Director-Treasury Services for the Company.

By letter dated January 22, 2003, CVPS filed Supplemental Testimony of Alf Strom-Olsen. By letter dated January 30, 2003, CVPS filed a draft 43d Supplemental Indenture, and stated that the 43d Supplemental Indenture also provided for the succession of Trustee from State Street Bank and Trust Company to U.S. Bank National Association. The Company also stated that the 43d Supplemental Indenture would be further amended to revise and streamline the mechanics of future Trustee successions. By letter dated February 28, 2003, CVPS filed Revised Supplemental Testimony of Alf Strom-Olsen, which corrected previously filed testimony and exhibits, and also filed the final form of the 43d Supplemental Indenture.

By letter dated November 25, 2002, CVPS gave notice of the petition to the Vermont Department of Public Service ("DPS" or the "Department") and requested a determination from the Department pursuant to 30 V.S.A. § 202(f) that entering the 43d Supplemental Indenture is consistent with the Vermont Twenty-Year Plan. The Department's Determination Under 30 V.S.A. § 202(f) was filed with the Board by letter dated February 26, 2003 (the "DPS Determination"). In the DPS Determination, the Department notified the Board that the DPS waives its rights under 3 V.S.A. § 811¹ and its opportunity for hearing under 30 V.S.A. § 108(a), provided the Board adopts the recommendations and conditions contained in the DPS Determination (the "DPS Waiver"). By letter dated March 10, 2003, to the Board, CVPS waived its rights under 3 V.S.A. § 811 and its opportunity for hearing under 30 V.S.A. § 108(a) and agreed to the Board adopting the recommendations and conditions contained in the DPS Determination (the "CVPS Waiver and Agreement").

In accordance with CVPS' request, the Board notified the Connecticut Department of Public Utility Control ("CT DPUC") that the Board was exercising jurisdiction over the petition.

I have reviewed the petition, the DPS Determination, the DPS Waiver, the CVPS Waiver and Agreement and the supporting testimony and exhibits. I conclude that approval of CVPS' petition to enter into a 43d Supplemental Indenture to allow the Company to use extensions and purchased property to satisfy Indenture Renewal Fund requirements, to provide for the succession of Trustee from State Street Bank and Trust Company to U.S. Bank National Association, and to revise and streamline the mechanics of future Trustee successions, all as described in the petition, prefiled testimony and exhibits, pursuant to 30 V.S.A. § 108(a), is appropriate and that such approval may occur without hearing. Based upon the agreements and statements contained in the petition, the DPS Determination, the DPS Waiver, the CVPS Waiver and Agreement and the supporting testimony and exhibits presented in this Docket, I hereby report the following findings and conclusions to the Board in accordance with 30 V.S.A. § 8.

¹The statute does not require a hearing, but rather the opportunity for a hearing. 30 V.S.A. § 108.

II. FINDINGS OF FACT

1. Central Vermont is a company as defined by 30 V.S.A. § 201, and is subject to the jurisdiction of the Board pursuant to 30 V.S.A. § 203. Petition at 1.

2. CVPS is requesting approval of a 43d Supplemental Indenture, amending its First Mortgage Indenture to allow CVPS to use extensions and purchased property to satisfy Indenture Renewal Requirements, when such property may not now be used because of the existing Second Mortgage on such property. Petition, generally. The 43d Supplemental Indenture will also provide for the succession of Trustee from State Street Bank and Trust Company to U.S. Bank National Association, and revise and streamline the mechanics of future Trustee successions. Final form of 43d Supplemental Indenture; filing letters of January 30, 2003, and February 28, 2003.

3. Article VII of the existing Indenture provides that CVPS will expend annually a 2.25% "Renewal Requirement," which is intended to assure the Bondholders that property securing the Bonds is replenished each year. This Renewal Requirement may be satisfied with (a) extensions or purchased property "on account of which the Company would be entitled . . . to have bonds authenticated under the provisions of Section 4 of Article II hereof . . ." or (b) the "redemption, payment or purchase and cancellation of any bonds issued under . . . this Mortgage" "Extensions" means additional constructed utility property, such as lines and substations. Article II, Section 4, eliminates the use of extensions and purchased property for such use when a second mortgage exists on such property. Strom-Olsen pf. 11/25/02 at 3.

4. In 1999, CVPS entered a Second Mortgage with The Bank of New York and issued \$75,000,000 of Second Mortgage Bonds thereunder, which remain outstanding and are due in 2004. This Second Mortgage is permissible under the First Mortgage, and is expressly subordinated to the First Mortgage. CVPS anticipated in 1999, and does so today, that its future long-term capital needs could be met through issuance of Second Mortgage Bonds, leading to the eventual phase-out of the First Mortgage Indenture. Strom-Olsen pf. 11/25/02 at 3.

5. Since 1999, CVPS has satisfied the Renewal Requirement through the use of redeemed First Mortgage Bonds, as CVPS cannot use property for such purposes. CVPS have sufficient redeemed bonds to satisfy the Renewal requirement into 2004. Exhibit ARS-3. This

creates a problem for CVPS in 2004. In 2004, CVPS will need to issue new bonds to replace the \$75,000,000 of existing Second Mortgage Bonds which expire August 1, 2004. The new issue could be either First or Second Mortgage Bonds ("FMBs" or "SMBs"); however, as CVPS will exhaust available redeemed bonds in 2004 to use for Renewal Requirement purposes, CVPS will need to have its extensions and purchased property unencumbered by a second mortgage at that time so that it may use such property for Renewal Requirement purposes. This precludes the issuance of new SMBs in 2004, and would require CVPS to issue new FMBs, *pari passu*, thus diluting the interest of the existing First Mortgage Bondholders. Strom-Olsen pf. 11/25/02 at 5.

6. Being able to apply extensions and purchased property to satisfy the Renewal Requirement also allows CVPS to retain the value of redeemed FMBs to use for issuance of additional FMBs, in the event the Company desired to do so. CVPS desires to provide for its long-term financing needs through SMBs under the more modern Second Mortgage, enabling eventual retirement of the First Mortgage Indenture, first entered in 1929. Strom-Olsen pf. 11/25/02 at 4, 5.

7. CVPS has obtained the First Mortgage Bondholders' consent to amend the First Mortgage Indenture with a 43d Supplemental Indenture to permit the use of extensions and purchased property to satisfy the Renewal Requirement (but not for the purpose of issuing FMBs) when a second mortgage exists on such property, thus allowing CVPS to (a) satisfy the ongoing Renewal Requirement without exhausting available redeemed bonds in 2004, (b) issue new SMBs in 2004 to replace the existing SMBs, issue new SMBs to provide liquidity as necessary after 2004. Section 4 of Article XVI of the First Mortgage requires the consent of such an amendment from Bondholders representing at least 66 2/3% for the First Mortgage Bonds. Strom-Olsen pf. 11/25/02 at 5, 6.

8. The Bondholders have requested, and CVPS has agreed to (subject to Public Service Board approval), the following additional amendments to the First Mortgage, which are included in the 43rd Supplemental Indenture: (i) an amendment providing that if Bonds are accelerated following a default, a Make-Whole premium, in addition to principal and interest, would be payable; (ii) an amendment providing that the optional par call for the five-year period prior to the due date of the GE Bonds, Series OO, due in 2023 would be changed to an optional

call at a Make-Whole premium; and (iii) if any other Bonds are subject to an optional par call, the par call would be changed to an optional call at a Make-Whole premium. All FMBs outstanding at January 1, 2003 (Series HH, JJ, MM, NN and OO) contain Make-Whole provisions previously approved by the Board; these amendments would merely extend the provisions to the circumstances described above. The Make-Whole provisions for each Series are different, as each Series of Bonds is for different terms with different initial interest rates. CVPS provided a copy of each Series' Make-Whole provision in Exhibit CVPS ARS-5. No Bondholder requested any fees for this transaction; however, CVPS will pay the fees of Chapman & Cutler, counsel to the Bondholders. Strom-Olsen pf. 11/25/02 at 5-7.

9. CVPS' printing costs will be minimized by the Company handling all printing and binding in-house. CVPS' legal needs are also being handled in-house, with the exception of out-of-state opinions, for which CVPS expects to pay approximately \$10-15,000 in total. In addition, CVPS will pay the usual mailing and recording fees on a town-by-town basis. Strom-Olsen pf. 11/25/02 at 8.

10. The 43d Supplemental Indenture does not grant a Make-Whole premium where none exists. The change extends the existing Make-Whole premiums to a default situation that forces the acceleration of the payment of FMB's (only likely in a CVPS bankruptcy circumstance). CVPS is not asking to grant a Make-Whole premium, but rather to extend the existing premiums in the situation of a default that causes acceleration of principal. For the Series OO bonds, CVPS is requesting an extension of the existing Make-Whole premium for the period 2019-2023. A voluntary prepayment during that period is unlikely. Strom-Olsen Revised Supplemental pf. 2/28/03 at 2.

11. The 43d Supplemental Indenture extends the existing Make-Whole premiums for two circumstances: (i) on all series of existing FMBs in the *case of a default* that leads to acceleration of the payment of principal; and (ii) for the Series OO Bonds for the period 2019-2023 (the Series OO Bonds have a Make-Whole premium through 2018; all other existing FMBs already have Make-Whole premiums for their entire terms). Under a *default* scenario, CVPS would find itself in a position to pay-off \$46 million of FMBs, \$75 million of SMBs, and \$16.3 million of Industrial Development/Pollution Control bonds. If that default scenario were to

occur, CVPS would be bankrupt whether it extended the Make-Whole premium on the FMBs or not; therefore, the question of extending the current Make-Whole premium *in case of default* is not a cost issue but a value allocation issue in a bankruptcy situation. The FMB holders want this provision to protect their position in the unlikely case of CVPS bankruptcy. Strom-Olsen Revised Supplemental pf. 2/28/03 at 2.

12. The issue of extending the existing Make-Whole premium for the period of 2019 through 2023 on the Series OO Bonds could be considered a more predictable, but still unlikely, cost issue. If CVPS were to be in a position to redeem the \$17.5 million Series OO Bonds at the beginning of 2019, the Make-Whole premium would be about \$1.1 million, and would decrease to \$0 at maturity in 2023. The Series OO Bonds are at 6.9% fixed interest rate. With this generally low rate, and given costs of remarketing and refinancing, it is highly unlikely that voluntary redemption and refinancing would ever make sense for CVPS. Even in today's extraordinary market, utility bond yield averages (based on Moody's) are 7.47% for Baa rated bonds (equivalent to CVPS's BBB rated FMBs). (See Exhibit CVPS ARS-7: Moody's "Credit Market Trends Service.") Accordingly, CVPS believes it is unlikely yields will decrease to a point where redemption of 6.9% bonds at par is reasonable. Strom-Olsen Revised Supplemental pf. 2/28/03 at 2, 3.

13. Without this 43d Supplemental Indenture, CVPS could be in a position of exhausting its capacity for any mortgage financing. In that case, CVPS would be required to rely on unsecured long-term financing. CVPS has capacity to secure some limited short-term financing facilities with its accounts receivable assets. In today's environment, the market for unsecured electric utility debt is significantly reduced and issuing such bonds could be difficult. Strom-Olsen Revised Supplemental pf. 2/28/03 at 2.

14. Without this amendment, there is a risk of CVPS being in default under the First Mortgage Indenture. Exhibit CVPS ARS-8 (Revised) summarizes the estimated capacity of CVPS to satisfy the Renewal Fund requirements under the First Mortgage if CVPS did not receive approval for the amendment. Using FMBs for refinancing \$75 million of SMBs coming due in 2004 and \$3.0 million of Series NN FMB's in 2008 would effectively exhaust CVPS' capacity to issue other long-term debt secured by utility property; in addition, this use would

severely limit available property and redeemed bonds for use in satisfying the Renewal Fund requirements under the First Mortgage Indenture. In 2008, as shown on Exhibit ARS-8 (Revised), the available property to satisfy the Renewal Funds becomes a negative number (as explained on Exhibit ARS-8 (Revised), use of \$3.0 million in redeemed bonds mitigates the 2008 deficiency, but due to the narrow margin and uncertainty of forecasts of capital expenditures, the potential for deficiency is still very close in 2008). Failure to satisfy the Renewal Fund requirement is a default under the First Mortgage Indenture and could accelerate the payment of all of CVPS's outstanding debt as identified above. Strom-Olsen Revised Supplemental pf. 2/28/03 at 4, 5.

15. The 43d Supplemental Indenture has no effect on future FMBs, which may or may not have Make-Whole premiums, depending on negotiations at the time. Strom-Olsen Revised Supplemental pf. 2/28/03 at 6.

16. The Company believes the new 43d Supplemental Indenture, and the Company's obligations thereunder, are consistent with the Department of Public Service's Vermont Twenty-Year Electric Plan. Allowing the use of extensions and purchased property to satisfy Renewal Requirement obligations allows the Company to retain the value of redeemed FMBs and to maintain the ability to issue SMBs to satisfy the Company's long-term financing needs. Strom-Olsen pf. 11/25/02 at 8. The Department of Public Service has provided the Board with a determination of compliance with the Vermont Twenty-Year Electric Plan, provided that the Board's order does not imply approval of any financing that may result from or be facilitated by the 43d Supplemental Indenture, the capital structure or cost of capital resulting or facilitated by it, or the use of funds raised by any such financing. In addition, the Board's order should not imply approval of rate recovery for any costs associated with such activities. DPS Determination. The Company has agreed to these provisions. CVPS Waiver and Agreement.

17. The Company's Board of Directors has approved these transactions. Strom-Olsen pf. 11/25/02 at 3; exhibit CVPS ARS-6; final form of 43d Supplemental Indenture (including approving resolutions).

18. Approval of CVPS' request to enter a 43d Supplemental Indenture will be consistent with the general good of the State of Vermont as required by 30 V.S.A. § 108(a).

III. CONCLUSION

On the basis of the evidence of record, I recommend that the terms and conditions proposed by the CVPS petition filed pursuant to 30 V.S.A. § 108(a) with the Vermont Public Service Board, seeking approval to enter into a 43d Supplemental Indenture, amending Central Vermont's First Mortgage Indenture, to allow the Company to use extensions and purchased property to satisfy Indenture Renewal Fund requirements, as extensions and purchased property may not now be used because of the existing Second Mortgage on such property, to provide for the succession of Trustee from State Street Bank and Trust Company to U.S. Bank National Association, and to revise and streamline the mechanics of future Trustee successions, all as described in the petition, prefiled testimony and exhibits, pursuant to 30 V.S.A. § 108, should be approved by the Board as consistent with the general good of the State of Vermont. I also recommend that this matter be decided without hearing pursuant to Board Rule 2.219.

All parties to this proceeding have waived the opportunity to comment on this Proposal for Decision in accordance with 3 V.S.A. § 811.

Dated at Montpelier, Vermont, this 19th day of March, 2003.

s/Ennis John Gidney

Ennis John Gidney

Hearing Officer

IV. ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The Findings and Conclusion of the Hearing Officer are adopted.
2. The terms and conditions proposed by the CVPS petition filed pursuant to 30 V.S.A. § 108(a) seeking approval to enter into a 43d Supplemental Indenture, amending Central Vermont's First Mortgage Indenture, to allow the Company to use extensions and purchased property to satisfy Indenture Renewal Fund requirements, as extensions and purchased property may not now be used because of the existing Second Mortgage on such property, to provide for the succession of Trustee from State Street Bank and Trust Company to U.S. Bank National Association, and to revise and streamline the mechanics of future Trustee successions, all as described in the petition, prefiled testimony and exhibits, pursuant to 30 V.S.A. § 108, are approved.
3. This Order does not constitute approval of any financing that may result from or be facilitated by the 43d Supplemental Indenture, the capital structure or cost of capital resulting or facilitated by it, or the use of funds raised by any such financing. In addition, the Order does not constitute approval of rate recovery for any costs associated with such activities. Nothing in this approval shall preclude the Department or any other party, or the Board, from reviewing and/or challenging those expenditures and/or the Company's resulting capital structure in any future proceeding.
4. CVPS shall provide the Board and the Department with an executed 43d Supplemental Indenture when it is available.

Dated at Montpelier, Vermont, this 19th day of March, 2003.

<u>s/Michael H. Dworkin</u>)	
)	PUBLIC SERVICE
)	
<u>s/David C. Coen</u>)	BOARD
)	
)	OF VERMONT
<u>s/John D. Burke</u>)	

OFFICE OF THE CLERK

FILED: March 19, 2003

ATTEST: s/Susan M. Hudson
Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: Clerk@psb.state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.